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Supreme Court, U.S.
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No. 02-1213

IN THE

Supreme Court of the United States

XU LIU AND XIAOMEI YANG,

Petitioners,

v.

PRICE WATERHOUSE LLP AND
COMPUTER LANGUAGE RESEARCH, INC.,

Respondents.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF IN OPPOSITION

LESLIE M. SMITH
KIRKLAND & ELLIS
200 East Randolph Dr.
Chicago, IL 60601

CRAIG A. KNOT
714 Perth Avenue
Flossmoor, IL 60422

CHRISTOPHER LANDAU
Counsel of Record
KIRKLAND & ELLIS
655 Fifteenth St., N.W.
Washington, DC 20005
(202) 879-5000

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TABLE OF CONTENTS

Page

RULE 29.6 STATEMENT ii

TABLE OF AUTHORITIES iii

INTRODUCTION 1

COUNTERSTATEMENT OF THE CASE 3

REASONS FOR DENYING THE WRIT 5

THE SEVENTH CIRCUIT CORRECTLY APPLIED SETTLED LAW 5

A. The Copyright Act Authorizes Copyright Owners To Place Conditions On A License To Prepare A Derivative Work, Including Ownership Of The Copyright In The Derivative Work 6

B. Petitioners' Argument Ignores the Settled Copyright Law Applied by the Seventh Circuit. 10

C. The Decision Below Does Not Implicate Any Important National Issues. 14

CONCLUSION 15

RULE 29.6 STATEMENT

Respondent Price Waterhouse LLP, now known as PricewaterhouseCoopers LLP, is a limited liability partnership registered in Delaware. PricewaterhouseCoopers LLP has no corporate parent, and no publicly traded company owns 10% or more of its stock.

Respondent Computer Language Resources, Inc. is now known as Thomson Professional & Regulatory Inc. This entity has the following corporate parents: The Thomson Corporation, Thomson Canada Limited, Thomson U.S. Holdings Inc., Thomson Corporation U.S.A. Inc., ThomCorp No. 4 Inc., ThomCorp No. 5 Inc., THI (U.S.) Inc., Thomson U.S. Inc., The Thomson Corporation Delaware Inc., Thomson Healthcare Inc., and Thomson Financial Inc. The Thomson Corporation, a corporation organized in Ontario, Canada, is a publicly held company that is listed on the Toronto and New York Stock Exchanges. No other public company owns 10% or more of the party's stock.

TABLE OF AUTHORITIES

Page

CASES

Arthur Rutenberg Homes, Inc. v. Drew Homes, Inc.,
29 F.3d 1529 (11th Cir. 1994) 12, 13
Aymes v. Bonelli,
980 F.2d 857 (2d Cir. 1992) 12, 13
Community for Creative Non-Violence v. Reid,
490 U.S. 730 (1989) 13
Effects Assocs., Inc. v. Cohen,
908 F.2d 555 (9th Cir. 1990) 13
Gilliam v. ABC, Inc.,
538 F.2d 14 (2d Cir. 1976) 6, 7, 11, 12, 14
S.O.S., Inc. v. Payday, Inc.,
886 F.2d 1081 (9th Cir. 1989) 6, 7, 8, 11, 14
Stewart v. Abend,
495 U.S. 207 (1990) 6, 7, 14

STATUTES AND RULES

17 U.S.C. § 106 ..... 1, 6, 11
17 U.S.C. § 106(2) 1, 6, 11, 12, 14
17 U.S.C. § 201 ..... 11, 12
17 U.S.C. § 201(a) 9, 11

OTHER AUTHORITIES

Nimmer, Melville B. & Nimmer, David,
Nimmer on Copyright (2002) 5, 9, 13, 14

INTRODUCTION

This is a straightforward case about the scope of a license to prepare a derivative work. Respondent Price Waterhouse owned the copyright in a computer software program, and licensed some programmers in China to prepare a derivative work based on that program. That license, as found below by a jury, provided that Price Waterhouse would own the copyright in the derivative work. Petitioners do not like that factual finding, but because they know it would be futile to challenge the sufficiency of the evidence, they now contend that the license does not matter, and that they own the copyright in the derivative work as a matter of law *regardless* of the scope of the license. Although petitioners attempt to depict themselves as copyright champions, what they are pursuing here is a radical rollback of the rights of copyright owners, who would be legally unable to authorize the creation of derivative works in which they owned the copyright. That extreme position has never been accepted by any court, which explains why petitioners failed to garner the vote of a single judge below, and cannot allege a circuit split.

Petitioners are thus reduced to arguing that *certiorari* is warranted here on the ground that the decision below "flagrantly contradicts the plain language of the Copyright Act." Pet. 8. But the Act does not say that the owner of an original work cannot contractually authorize the creation of a derivative work in which it owns the copyright. To the contrary, the Act expressly grants the owner of an original work the "exclusive rights" to "prepare derivative works based upon the copyrighted work." 17 U.S.C. § 106(2). Among these "exclusive rights" is the right to place conditions on the preparation of a derivative work, including ownership of the copyright in the derivative work. Indeed, the creation of a derivative work *without* authorization from the owner of the original work would infringe the copyright in the original work.

The only question here, therefore, is whether the Copyright Act vests the authors of derivative works with an *inalienable* right to the copyright in their work. The answer to that question is no. The general rule in our legal system is that persons are free to alienate their statutory rights, and nothing in the Copyright Act suggests anything to the contrary. If potential authors, like the Chinese programmers here, do not want to create derivative works without owning the copyright, then they do not have to accept the terms of a license imposing such a condition. But they cannot *accept* the terms of a license imposing such a condition, and then turn around (after the license is construed against them) and argue that they own the copyright in the derivative work created pursuant to that very license. Nothing in the Copyright Act, in short, allows petitioners to have it both ways: having accepted the license to create the derivative work in the first place, they must abide by the conditions of that license, including the condition that the owners of the original work would own the copyright in the derivative work.

At bottom, petitioners simply refuse to accept the jury's factual finding that the parties here contractually agreed that the copyright in the derivative work would belong to Price Waterhouse rather than the Chinese programmers. Petitioners' attempt to recast this factual issue as a legal issue of great importance fails for the simple reason that potential authors who want to own the copyright in a derivative work do not have to accept a license that would vest such ownership in the owner of the original work. Given that no court has ever accepted petitioners' extreme and untenable position that the Copyright Act overrides such license conditions, and that the leading commentator in this area has flatly rejected that position, it is petitioners who are seeking to upset settled understandings in this area of the law. Accordingly, and for the reasons set forth more fully below, this Court should deny the petition.

COUNTERSTATEMENT OF THE CASE

Respondent Price Waterhouse developed a tax preparation software package known as the Tax Management System ("TMS"). Pet. App. A2. The original RevUp32 program (or "pre-China RevUp32") is a small part of the Windows version of that software. *Id.* The pre-China RevUp32 program allows other parts of the TMS software to gain access to the TMS database. *Id.* It is undisputed that Price Waterhouse owned the copyright to the pre-China RevUp32 program. *Id.*

Petitioner Yang was a computer programmer employed by Price Waterhouse's Tax and Technology Group. *Id.* In March 1995, Price Waterhouse sent Yang to China to seek out programmers who could improve the speed of the pre-China RevUp32 program. *Id.* Yang selected programmers from the Sichuan Sky Company Limited. *Id.*

The license authorizing Yang and the Chinese programmers to work on the project and defining the scope of that authorization was memorialized in a June 7, 1995 letter to Yang from Price Waterhouse's Jerry Niles. Pet. App. A2-3. This letter was "a part of the written assurances [which] were necessary to induce the Chinese programmers to proceed with their work." Pet. App. B3 (internal quotations omitted). The letter set forth the incentive-based compensation that Yang and the Chinese programmers would receive if they reached certain goals, and provided that any enhancement to the pre-China RevUp32 program would become Price Waterhouse's property upon completion of the project:

> The Tax Technology Group will supply the source code for RevUp .... It is clearly understood that the source code is the sole property of Price Waterhouse and Price Waterhouse gives no authority, implied or otherwise, to distribute or copy this source code in any way. Upon

> completion of the project, ALL source code will be given back to Price Waterhouse.

Pet. App. A3. Yang herself confirmed this understanding of the license in a November 1995 e-mail to Price Waterhouse: "According to the agreement, the enhancement in the source code becomes the property of PW upon the completion of the project." DX 3 ¶ 4; *see also id.* ("[T]he terms of my agreement with the Chinese programmers follow the exact terms spelled out in Jerry Nile's [*sic*] letter.").

Using the source code to the pre-China RevUp32 program, the Chinese programmers developed an enhanced version of the program (called "China RevUp32" below). Pet. App. A3-4. Upon completion of the project, however, Yang refused to give Price Waterhouse the source code for the China RevUp32 program unless the company guaranteed her future work on top of the $264,000 the company had agreed to pay under the compensation formula set forth in the license. *Id.* at A4. Price Waterhouse refused. *Id.*

Undeterred, Yang then arranged for the Chinese programmers to sell their alleged copyright in the derivative China RevUp32 program to petitioner Liu (Yang's teenage daughter) for $150. *Id.* (Yang could not register a copyright in her own name, because she had signed employment agreements with Price Waterhouse providing that it would own the rights to any programs on which she worked during the course of her employment. *See* Pet. App. C15-16.). Liu then registered a copyright, and brought this infringement action against Price Waterhouse and respondent Computer Language Research, Inc. ("CLR"), which had purchased most of the assets of Price Waterhouse's Tax Technology Group in late 1995.

After discovery, Price Waterhouse and CLR moved for summary judgment on the ground that the June 7, 1995 license established that Price Waterhouse owned the copyright to the derivative China RevUp32 program. The district court

(Holderman, J., N.D. Ill.) denied the motion, holding that a genuine issue of material fact existed with respect to the scope of the license. Pet. App. B6. Accordingly, the case proceeded to trial with the meaning of the license as the central issue. The jury unanimously rejected petitioners' interpretation of the license and found that "the China RevUp32 program, *including the copyright*, would become the property of Price Waterhouse upon completion of the project." Pet. App. C15 (emphasis added). The district court then entered judgment for Price Waterhouse and CLR on the jury's verdict, Pet. App. C1-2, and denied petitioners' motion for judgment as a matter of law, Pet. App. D.

Petitioners appealed, and the Seventh Circuit unanimously affirmed the judgment. In particular, the court rejected as "flawed" petitioners' argument that the Copyright Act gave the authors of a derivative work an inalienable copyright in that work. Pet. App. A8. Petitioners sought rehearing and rehearing *en banc*, but their petitions were denied without garnering the vote of a single judge. Pet. App. E1. The petition for *certiorari* followed.

REASONS FOR DENYING THE WRIT

THE SEVENTH CIRCUIT CORRECTLY APPLIED SETTLED LAW

The decision below comports with the Copyright Act, this Court's precedents, the decisions of other courts of appeals, and *Nimmer on Copyright*, which petitioners themselves characterize as "[t]he leading and oft-quoted treatise in the field." Pet. 11. Indeed, it is petitioners' position that conflicts with the Copyright Act, this Court's precedents, the decisions of other courts of appeals, and *Nimmer on Copyright*. Accordingly, there is no need for this Court to review the Seventh Circuit's straightforward application of settled law.

A. The Copyright Act Authorizes Copyright Owners To Place Conditions On A License To Prepare A Derivative Work, Including Ownership Of The Copyright In The Derivative Work.

The crux of petitioners' argument is that the Copyright Act precludes copyright owners from placing a condition on the preparation of a derivative work providing that they own the copyright in that work. That position ignores the fundamental fact that derivative works are inherently creatures of license. Licenses are critical with respect to derivative works because Section 106(2) of the Copyright Act provides that the owner of a copyright "has the exclusive rights to do and to authorize ... [the preparation of] derivative works based upon the copyrighted work." 17 U.S.C. § 106(2) Thus, a potential author of a derivative work *must* have the authorization of the copyright owner, and "[i]n fact, this Court has held that a copyright owner has the capacity arbitrarily to refuse to license one who seeks to exploit the work." *Stewart v. Abend*, 495 U.S. 207, 229 (1990). Without a license, the author of a derivative work would infringe the original work. *See id.* at 223 (noting "the axiomatic copyright principle that a person may exploit only such literary material as he either owns or is licensed to use") (internal quotation and citation omitted); *see also* Pet. App. D10 n.1 ("A derivative work author ... is by definition working within the confines of his or her license to create that work and is bound not to infringe the rights of the original work's owner by exceeding the scope of that license.").

Thus where, as here, a copyright in a derivative work is at issue, the "critical question is ... the scope of the license." *S.O.S., Inc. v. Payday, Inc.*, 886 F.2d 1081, 1087-88 (9th Cir. 1989). "A licensee infringes the owner's copyright if its use exceeds the scope of its license." *Id.* at 1087; *accord Gilliam v. ABC, Inc.*, 538 F.2d 14, 20 (2d Cir. 1976) (author of derivative work infringes copyright in the original work if he "exceed[s] the specific purpose for which permission was granted"). And a

"license must be construed in accordance with the purposes underlying federal copyright law. Chief among these purposes is the protection of the author's rights." *S.O.S.*, 886 F.2d at 1088 (citations omitted).

The "author" whose rights are protected by federal copyright law when a work is licensed to another is the author of the original work. Thus, in *Stewart*, this Court ruled in favor of the successor to the original author's rights and against a movie producer who continued to market a derivative work based on the original novel. Because such continued marketing was beyond the scope of the original "grant of rights," 495 U.S. at 213, this Court held that the marketing was "contrary to the axiomatic copyright principle that a person may exploit only such copyrighted literary material as he either owns *or is licensed to use*." *Id.* at 223 (emphasis added; internal quotation and citation omitted).

The Second Circuit in *Gilliam* also protected the rights of the original owner/licensor against a franchisee who violated the conditions of the license. In *Gilliam*, the British comedy group "Monty Python" licensed scripts to the British Broadcasting Corporation ("BBC") for use in the television series "Monty Python's Flying Circus." *Gilliam*, 538 F.2d at 17. The license did not authorize the BBC to edit a program once it had been recorded. *Id.* The BBC then licensed ABC to broadcast the series in the United States, but this license permitted editing of the programs. *Id* at 17-18, 21. Monty Python sued when ABC began broadcasting edited programs, *id.* at 19, and the Second Circuit enjoined further broadcast. "Since the copyright in the underlying script survives intact despite incorporation of that work into a derivative work, one who uses the script, even with the permission of the proprietor of the derivative work, may infringe the underlying copyright." *Id.* at 20. Even "[o]ne who obtains permission to use a copyrighted script in the production of a derivative work, ... may not exceed the specific purpose for which permission was granted." *Id.*

The Ninth Circuit's decision in *S.O.S.* also protected the rights of the original author from a licensee who exceeded the scope of its license. In *S.O.S.*, the plaintiff software firm licensed some of its payroll software to another company, Payday. The license said: "[t]his series of programs is the property of SOS, and PAYDAY is acquiring the right of use, SOS retains all rights of ownership." *S.O.S.*, 886 F.2d at 1083. When Payday began making changes to the program, S.O.S. sued, and the Ninth Circuit ruled in S.O.S.' favor. Observing that protecting the rights of the author of the program being licensed was "chief" among the "purposes underlying federal copyright law," the Ninth Circuit examined the status of the parties (Payday was not a software writer, *id.* at 1088 n.8) and the language of the license to conclude that "neither party expected Payday to be able to gain access to the source code itself, as opposed to putting in its customers' data and receiving output." *Id.* at 1088.

The Seventh Circuit followed these precedents by holding that actions that exceeded the scope of the license to use the original work constituted infringement. Pet. App. A7-10. The court began with the June 7, 1995 license. *See id.* at A8. On appeal, petitioners understandably did not challenge the jury's finding that the license specified that "the China RevUp32 program, *including the copyright,* would become the property of Price Waterhouse upon completion of the project" or that the project as contemplated by the license was complete. Pet. App. C15 (emphasis added). The question, therefore, became whether the Chinese programmers were entitled to claim a copyright in the derivative China RevUp32 program, register that copyright, and sell it to Liu for $150, *notwithstanding* the terms of the license that authorized the derivative work in the first place.

The answer to that question was and is no. Nothing in the Copyright Act purports to preclude parties from agreeing by contract to vest the copyright in a derivative work in the party

granting the license to prepare that work. To the contrary, the "background presumption" in our legal system is that "legal rights generally ... are subject to waiver by voluntary agreement of the parties." *United States v. Mezzanatto*, 513 U.S. 196 (1995). Petitioners thus miss the point by simply insisting that "'[c]opyright in a work protected under this title vests initially in the author or authors of the work.'" Pet. 10 (quoting 17 U.S.C. § 201(a)). The question here is whether parties can agree, as a condition for a license to prepare a derivative work, that the copyright in the derivative work will belong to the owner of the copyright in the original work. Petitioners identify no authority to support their position that the statute prohibits such a license condition.

Indeed, that extreme position is inconsistent with (in petitioners' own words) "[t]he leading and oft-quoted treatise in the field," Pet. 11, *Nimmer on Copyright*. As that treatise explains: "[I]f the pertinent agreement between the parties affirmatively bars the licensee from obtaining copyright protection even in a licensed derivative work, that contractual provision would appear to govern." 1 *Nimmer on Copyright* § 3.06 at 3-34.26 (2002). Indeed, "if not claiming copyright in the derivative work is a condition to the license, a violation of that condition might void the license altogether, thereby rendering the making of the derivative work itself an act of copyright infringement. It would thereupon follow that no copyright could be claimed in the derivative work." *Id.* at 3-34.26(1) n.29 (citation omitted).

Because this case involves the *initial* ownership of the copyright in a derivative work created pursuant to a license, petitioners' reliance on the statutory provision regarding *transfer* of such ownership is misplaced. As the Seventh Circuit recognized, there was never any need for the Chinese programmers to transfer ownership of the copyright in the derivative work to Price Waterhouse, since Price Waterhouse owned that copyright all along by virtue of the license that

authorized the derivative work in the first place. Pet. App. A9. "'While the Copyright Act makes authors of derivative works the presumptive owners of copyright rights in their contributions, it also allows parties to adjust those rights by contract. Here, the jury found that the parties to the [June 7, 1995] letter agreement did just that—agreed that Price Waterhouse would hold the copyright in the derivative work.'" *Id.* (quoting Pet. App. D14).

The decision below, therefore, is simply an application of the principle that the owner of copyright may place conditions on a license to prepare a derivative work, including specifying who will own the copyright in the derivative work. Because the jury found that the license here gave Price Waterhouse ownership of the copyright in the derivative work (a factual finding that petitioners do not purport to challenge), the Seventh Circuit properly affirmed the judgment in respondents' favor.

B. Petitioners' Argument Ignores the Settled Copyright Law Applied by the Seventh Circuit.

At the very heart of petitioners' position is an inherent inconsistency: they embrace the June 7, 1995 license as the authorization necessary to create the derivative work, but reject the condition in that very license that the copyright in the derivative work would belong to Price Waterhouse. This inconsistency was not lost on the district court: "This court finds [petitioners'] argument that the letter agreement was sufficient to authorize the Sky Programmers to prepare the derivative work, even though the Sky Programmers did not sign it, but was not sufficient to limit the Sky Programmers' rights to claim a copyright in the derivative work to be internally inconsistent." Pet. App. D13.

And this inconsistency carries over into the petition, which cites the license as the "authorization for the creation of ... a derivative work," Pet. 4, but simultaneously refuses to acknowledge the corresponding limitations and conditions. The

Copyright Act, however, does not allow petitioners to have it both ways. As licensees, they must abide by the conditions attached to their license and the corresponding principle that "[a] licensee infringes the owner's copyright if its use exceeds the scope of its license." *S.O.S.*, 886 F.2d at 1087 (citing *Gilliam*, 538 F.2d at 20).

Perhaps aware of the inherent inconsistency in their position, petitioners seek to cast doubt on the June 7, 1995 license. *See, e.g.*, Pet. i (characterizing license as "an ambiguous unsigned writing"); *id.* at 7 (same); *id.* at 19-21 (challenging "the Seventh Circuit's interpretation of the June 7, 1995 Letter"). But the jury here found that the June 7 letter was a license that gave Price Waterhouse ownership of the copyright in the derivative work, and that petitioners are bound by that license. Those findings are not clearly erroneous, and petitioners cannot and do not claim otherwise.

At the end of the day, then, petitioners are left with the argument that the Chinese programmers (and then their *alter ego*, Liu) must own the copyright to ChinaRevUp32 because they authored it and 17 U.S.C. § 201(a) inalienably vests title in the author. *See, e.g.*, Pet. 10 ("[I]nitial ownership of the copyright is a foregone conclusion: such ownership vests in the Sky Company programmers as the authors of the work."). Once again, this argument ignores 17 U.S.C. § 106. Any analysis of copyright in derivative works must begin with that provision, which identifies the owner of the original work as the holder of "exclusive rights" to authorize the preparation of "derivative works based upon the copyrighted work." Section 106 qualifies these exclusive rights by stating that they are subject to "sections 107 through 122." Significantly, Section 201 is not among these qualifying sections. If Congress had intended to qualify Section 106(2)'s exclusive right to authorize the preparation of derivative works with the provisions of Section 201, it could have done so. As it is, Section 106(2) gives the

copyright owner exclusive rights over derivative works unqualified by Section 201.

Indeed, the copyright regime advocated by petitioners would render Section 106(2)'s exclusive rights hollow with respect to the commissioning of derivative works. Under petitioners' theory, a copyright owner who wanted to own the copyright in a derivative work could not do anything before the creation of such a work (except hire the author as an employee) to ensure that he would own the derivative copyright. Instead, he would have to hope that the author would execute a written transfer of the copyright *after* completing the derivative work. If the derivative author did not transfer the copyright, the original copyright owner would be out of luck.

Accepting petitioners' position would also lead to the anomalous result that the violation of a durational or media restriction in a license could give rise to an infringement, while the violation of a copyright ownership provision could not. It is well-settled that even relatively minor violations of durational or media conditions in a license (*e.g.*, extending a license period by one day or one week) can lead to an infringement finding. *See, e.g., Gilliam,* 538 F.2d at 20 (noting that "[m]ost of the decisions" involving infringement by exceeding the scope of a license for a derivative work "dealt with the improper extension of the underlying work into media or time, *i.e.*, duration of the license, not covered by the grant of permission to the derivative work proprietor") (citations omitted). But, in petitioners' world, significant violations—ones that go to the very ownership of the work being licensed—could not lead to an infringement finding. That anomaly has no basis in principle or precedent.

Nor is petitioners' position supported by the cases on which they rely in alleging a circuit split. Neither *Arthur Rutenberg Homes, Inc. v. Drew Homes, Inc.*, 29 F.3d 1529 (11th Cir. 1994) nor *Aymes v. Bonelli*, 980 F.2d 857 (2d Cir. 1992), has anything to do with a derivative work or a license. In *Rutenberg*, the Eleventh Circuit simply held that a written

assignment from an independent contractor to a homebuilder was sufficient under 17 U.S.C. § 204(a) to transfer the copyright. *See* 29 F.3d at 1531. And in *Aymes,* the Second Circuit simply applied the multifactor test of *Community for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989), and held that author of a computer program was an independent contractor, rather than an employee, of the defendant. 980 F.2d at 864.

Petitioners' reliance on the Ninth Circuit's decision in *Effects Assocs., Inc. v. Cohen*, 908 F.2d 555 (9th Cir. 1990), is similarly misplaced. Although that case did at least involve a derivative work, it did not involve a license that had anything to say about ownership of the copyright in that work. Indeed, when the parties reached an oral agreement that authorized the plaintiff to prepare the derivative work, "no one said anything about who would own the copyright in the footage." 908 F.2d at 556. As the district court noted, "[t]he cases cited by [petitioners'] counsel all concern situations under which one party indisputably authored and held ownership rights in the work, and the issue was whether that party had transferred those rights to another," Pet. App. D10 (citing, *inter alia*, *Effects*, 908 F.2d at 556-57), whereas "[h]ere, by contrast, the dispute turns upon which party was to initially hold the rights in the derivative work," Pet. App. D10.

Petitioners' separate argument that they did not engage in an unauthorized "use" of the underlying work, Pet. 15-19, is nothing more than a variation on the foregoing arguments. As noted above, petitioners' use of the original work was governed by the June 7, 1995 license. As the Seventh Circuit recognized, petitioners exceeded the scope of that license by asserting and registering a copyright in the derivative work. Pet. App. A8. Petitioners thus voided the license, and rendered "the making of the derivative work itself" and "claiming a copyright in the derivative work" acts of copyright infringement. *Nimmer on Copyright*, at 3-34.26(1) n.29; *see also* Pet. App. D14.

In sum, petitioners' efforts to identify a circuit split fall far short of the mark. The Seventh Circuit merely followed Section 106(2) of the Copyright Act, the principles set forth in *Stewart, Gilliam, S.O.S.*, and *Nimmer on Copyright*.

C. The Decision Below Does Not Implicate Any Important National Issues.

As shown above, the petition is essentially a frontal assault on Section 106(2) of the Copyright Act. As such, it is also an attack on the ability of copyright owners to clarify copyright ownership in the derivative works they commission from independent contractors. Petitioners claim to be in favor of "predictability" and "certainty" with respect to copyright ownership, Pet. 27 (internal quotations and citations omitted), but the effect of their position would be a sea change in the law. Copyright owners who have commissioned non-employees to produce derivative works with license terms relating to ownership, confident that Section 106(2) means what it says, would suddenly find that the law had changed from under them.

What is more, petitioners' post-106(2) world would seriously undermine the production of derivative works in this country. As noted above, under petitioners' theory, copyright owners seeking independent contractors to produce derivative works would no longer be able to secure initial copyright ownership in such works. Instead, they would be at the mercy of those they licensed to prepare the works. That would harm not only copyright owners, but also would-be authors of derivative works, who would find far fewer copyright owners willing to commission such works. That would turn the law upside down. Accordingly, preservation of settled expectations regarding licenses to prepare derivative works pursuant to Section 106(2) hinges on this Court's denial of the petition for *certiorari*.

CONCLUSION

For the foregoing reasons, this Court should deny the petition for writ of *certiorari*.

Respectfully submitted,

LESLIE M. SMITH
KIRKLAND & ELLIS
200 East Randolph Dr.
Chicago, IL 60601

CRAIG A. KNOT
714 Perth Avenue
Flossmoor, IL 60422

CHRISTOPHER LANDAU
Counsel of Record
KIRKLAND & ELLIS
655 Fifteenth Street, N.W.
Washington, DC 20005
(202) 879-5000